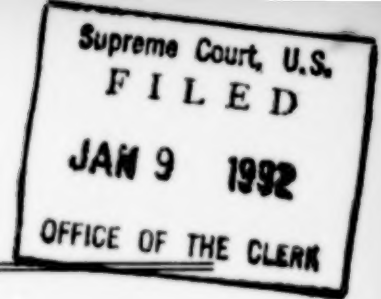


(4)
No. 91-615



In The
Supreme Court of the United States
October Term, 1991

ALLIED-SIGNAL, INC. as successor-in-interest to
The Bendix Corporation,

Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,

Respondent.

On Writ of Certiorari to the Supreme Court of the
State of New Jersey

BRIEF OF THE WILLIAMS COMPANIES, INC. AS
AMICUS CURIAE IN SUPPORT OF PETITIONER

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BRIEF OF THE WILLIAMS COMPANIES, INC. AS
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INTEREST OF AMICUS CURIAE

Pursuant to Rule 37 of the Rules of this Court, The Williams Companies, Inc., respectfully submits this brief as *amicus curiae* in support of Petitioner, Allied-Signal, Inc.¹ The Williams Companies, Inc. (hereinafter "TWC") is a Delaware corporation and a Fortune 500 company.

¹ The Williams Companies, Inc., has received the written consents of the Petitioner and Respondent to the filing of this brief; those consents have been filed with the Clerk of the Court.

TWC's principal place of business and commercial domicile is in Tulsa, Oklahoma. TWC is the parent company and owner, directly or indirectly, of a number of subsidiary corporations (hereinafter the "TWC Subsidiaries"), which are domestic corporations organized under the laws of various states. Some or all of the TWC Subsidiaries are engaged in commerce in virtually every state and file combined state income tax returns as a unitary business with TWC in fourteen states. Because state tax controversies surrounding the apportionability or allocability of income from minority investments of TWC and/or the TWC Subsidiaries have arisen in the past and will continue to surface, the Due Process rights conferred upon TWC and the TWC Subsidiaries will be directly affected by the resolution of this case.

This case involves the continued survival of this Court's interpretations of the Due Process Clause as articulated in *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425 (1980) (hereinafter "*Mobil*"), *Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 U.S. 207 (1980) (hereinafter "*Exxon*"), *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982) (hereinafter "*ASARCO*"), and *F.W. Woolworth Co. v. Taxation and Revenue Dep't*, 458 U.S. 354 (1982) (hereinafter "*Woolworth*"). In these cases the Court outlined the "nexus" and "rational relationship" standards which are necessary prerequisites to a state's taxation of interstate income. By improperly construing the principles set forth in this Court's prior decisions, the New Jersey Supreme Court rejected a long-established set of criteria that elucidated the Due Process Clause for thousands of business taxpayers and tax administrators and attempted

to replace it with a rule of law that provides virtually no standards.

If this decision stands, taxpayers throughout the nation will experience significant increases in the costs and burdens of allocation and apportionment of income due to the resulting uncertainty. As corporations that must contend daily with the interpretation and administration of the tax laws of the various states, TWC and the TWC Subsidiaries have a vital interest in the proper disposition of this case.

SUMMARY OF ARGUMENT

The Due Process Clause prevents a state from taxing "value earned outside its borders." *ASARCO*, 458 U.S. at 315. In a series of cases culminating in *ASARCO*, *Woolworth*, and *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983), this Court articulated the Due Process limits on a state's authority to tax income received by a nondomiciliary business from intangible property. Those cases made it clear that the "linchpin of apportionability" is the unitary business principle. See, e.g., *Woolworth*, 458 U.S. at 362. Moreover, in determining whether a unitary business existed, this Court's decisions have focused on the various elements of the relationship between the investor and the investee.

The New Jersey Supreme Court has applied a radically different approach to this area of the law. The court has taken the position that unitary business income also arises whenever the investment in the underlying

intangible serves a "corporate function." App. 19a.² Accordingly, the court required Respondent to apportion Bendix's gain from the sale of its ASARCO stock despite the lack of a unitary relationship between Bendix and ASARCO and based simply on the fact that Bendix had business reasons for selling the stock. Because this holding is contrary to existing Due Process jurisprudence, it should not be permitted to stand.

The Court's decision in this case will have obvious ramifications in nearly every State. The New Jersey Supreme Court has announced an interpretation of the Due Process Clause that would permit virtually all income from intangibles to be apportioned. While such a broad standard clearly is in the interest of Respondent,³ it would create in an enormous potential for double taxation. Many multistate businesses will find themselves paying tax on 100 percent of income from capital gains to their domiciliary states while paying tax on a percentage of the same income to the other states in which they do business. Under the amorphous standard set forth by the New Jersey Supreme Court, it will be just as easy for a state to contend that income is from the unitary business, and therefore apportionable, as it will be to assert that the same income is "nonbusiness" income allocable entirely

² References to "App." are to the appendix filed with Allied-Signal's Petition for a Writ of Certiorari to the Supreme Court of New Jersey.

³ Unlike the majority of states, New Jersey apportions all gains and dividends from intangibles and does not allocate such income, even if the taxpayer is domiciled in New Jersey. See generally N.J. Stat. Ann. tit. 54, ch. 10E.

to the domiciliary state. *Amicus* TWC has found itself increasingly caught in such binds as states seek to expand their tax bases to compensate for shrinking revenues. Only if this Court reaffirms the existence of substantial Due Process limitations will some degree of certainty return to this area of the law. If *Amicus* TWC and the many similarly-situated businesses are to avoid paying state-level tax twice on the same items of income, the New Jersey Supreme Court's analysis of the law must be rejected.

ARGUMENT

The decision of the New Jersey Supreme Court should be reversed by this Court, because the "standards" used to determine whether the capital gain recognized by Petitioner Allied-Signal on the sale of its stock in ASARCO, Inc. (hereinafter "ASARCO") was unitary business income apportionable to New Jersey are so broad that they constitute no standards at all. By misapplying or actually ignoring requirements established by this Court in ASARCO and related cases, apportionment of any part of Petitioner's gain on the sale of its ASARCO stock (hereinafter the "ASARCO Gain") by Respondent violated the Due Process Clause of the United States Constitution. See U.S. Const. Amend. XIV, § 1.

A. Due Process Requirements for Taxation

This Court has determined that the Due Process Clause, a primary limit on a state's ability to tax income

generated in interstate commerce, requires (1) a minimum connection or nexus between the taxing state and the activities of an interstate business, and (2) a rational relationship between the income attributed to the state and the intrastate values of the business. *Exxon*, 447 U.S. at 219-20; *Mobil*, 445 U.S. at 436-37; *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267, 272-73 (1978).

The Due Process "nexus" requirement is met if a corporation " 'avails itself of the "substantial privilege of carrying on a business" within the State.' " *Exxon*, 447 U.S. at 220 (quoting *Mobil*, 445 U.S. at 437). If the nexus requirement is met, an item of income may be carved out as an exception to the general rule of apportionability only if the taxpayer can "demonstrate something about the nature of this income that distinguishes it from operating income, a proper portion of which the State concededly may tax." *Id.* at 437-38; *ASARCO*, 458 U.S. at 317-18.

In *Mobil*, this Court considered whether Vermont could apportion and tax dividend income paid to Mobil, a corporation domiciled in New York, by its subsidiaries and affiliates doing business abroad. This Court found that neither the foreign source nor the dividend form of the income destroyed the nexus between the dividends and the State of New York. *Mobil*, 445 U.S. at 437-38. The *Mobil* case focused exclusively on the nexus prong of the dual Due Process requirements, as Mobil "made no effort to demonstrate that the foreign operations of its subsidiaries and affiliates [we]re distinct in any business or economic sense from its petroleum sales activities in Vermont." *Id.* at 439; see also *id.* at 435.

This Court has stated that the other requirement of Due Process, the rational relationship test, looks to the relationship between the income attributed to the state and the intrastate values of the taxpayer's business. The "proper inquiry looks to 'the underlying unity or diversity of business enterprise.' " *Woolworth*, 458 U.S. at 363. A state may apportion "corporate income from corporate activities beyond the state's border" only if the intrastate and extrastate activities form part of a single unitary business. *ASARCO*, 458 U.S. at 319. The out-of-state activities must be related in a "concrete way" to in-state activities. *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 166 (1983) (hereinafter "*Container*"). In other words, an exchange of value beyond "the mere flow of funds arising out of a passive investment" is necessary. *Id.*

ASARCO and *Woolworth* rejected broad brush approaches to the "unitary business" concept, which this Court has also called " 'the linchpin of apportionability.' " *Woolworth*, 458 U.S. at 362; *ASARCO*, 458 U.S. at 317. If a unitary business exists, a state may apply its apportionment formula to approximate the income " 'reasonably related' " to the activities within the taxing state. *Exxon*, 447 U.S. at 223.

In *Woolworth* this Court rejected the New Mexico Supreme Court's view that because *Woolworth's* ownership of certain foreign subsidiaries might improve its credit, business standing, and prestige, a unitary business relationship existed. The Court held that the rational relationship test requires more than that an asset merely "adds to the riches" of a corporation.

Income, from whatever source, always is a "business advantage" to a corporation. Our cases demand more. In particular, they specify that the proper inquiry looks to "the underlying unity or diversity of business enterprise," *Mobil*, 445 U.S., at 440, 100 S.Ct., at 1233, not to whether the nondomiciliary parent derives some economic benefit – as it virtually always will – from its ownership of stock in another corporation. See *ASARCO*, 458, U.S., at 325-329, 102 S.Ct., at 3113-3115.

Woolworth, 458 U.S. at 363-64.

ASARCO rejected a similar claim made by the State of Idaho. In that case, Idaho argued that intangible assets should be considered a part of a unitary business if the intangible property was " 'acquired, managed or disposed of for purposes relating or contributing to the taxpayer's business.' " 458 U.S. at 326. This Court declared that such a broad definition would "destroy the concept."

The business of a corporation requires that it earn money to continue operations and to provide a return on its invested capital. Consequently *all* of its operations, including any investment made, in some sense can be said to be "for purposes related to or contributing to the [corporation's] business." When pressed to its logical limit, this conception of the "unitary business" becomes no limitation at all.

Id. (emphasis in original).

For purposes of the unitary business principle, dividends and capital gains are treated in the same manner, because "[o]ne must look principally at the underlying

activity, not at the form of investment, to determine the propriety of apportionability." *Mobil*, 445 U.S. at 440; *ASARCO*, 458 U.S. at 330 (quoting *Mobil*).

In its analysis of the unitary business principle, this Court has identified certain factors that indicate the existence of a unitary business. The factors are "functional integration, centralization of management, and economies of scale." *Mobil*, 445 U.S. at 438; *Woolworth*, 458 U.S. at 364. While such elements existed in *Exxon*, see 447 U.S. at 224-25, and in other cases, they were not present in *ASARCO* or in *Woolworth*, and accordingly this Court found that Idaho and New Mexico, respectively, could not tax the income at issue in those cases. In *Woolworth*, for example, each subsidiary autonomously decided its own site selection, merchandise, and advertising, and each had an accounting department and financial staff; moreover, *Woolworth* engaged in no central purchasing, manufacturing or warehousing of merchandise. *Woolworth*, 458 U.S. at 365.

B. Standards Used by the New Jersey Supreme Court to Justify Apportionment of the ASARCO Gain

In reaching the conclusion that the ASARCO Gain and the gain on the sale of Petitioner's United Geophysical Corporation stock (hereinafter the "UGC Gain") were apportionable to New Jersey, the New Jersey Supreme Court used two radically different sets of criteria. Only the nexus and rational relationship standards used to defend New Jersey's apportionment of the UGC Gain, however, satisfy the Due Process requirements established by this Court. The analysis used by the New Jersey

Supreme Court to justify apportionment of the ASARCO Gain only superficially contains criteria resembling the standards established by this Court. Moreover, the criteria enunciated to defend apportionment of the ASARCO Gain are so vague that they would allow a state to justify apportionment of nearly any item of intangible income or loss of a multijurisdictional business. The New Jersey Supreme Court has added so much elasticity to the Due Process standards developed in decisions of this Court as to render them meaningless.

Although the New Jersey Supreme Court has purported to follow this Court's precedents in the area of interstate taxation, acceptance of the court's reasoning in this case will in essence mean that this Court has altered Due Process standards to conform with the positions rejected in *ASARCO* and *Woolworth*. In those cases and their predecessors, this Court identified the limits on state taxation of interstate income of a nondomiciliary business. The New Jersey Supreme Court, however, has rejected the notion that this Court has articulated a single governing standard based on the unitary business principle; instead, it asserts that "*there are a number of nonexclusive tests* utilized to determine the existence of a unitary business." App. at 15a (emphasis added).

Based on this notion, the New Jersey Supreme Court applied two entirely different tests in its decision. With regard to the UGC Gain (which is not an issue before this Court), the court applied the Due Process tests previously articulated by this Court. The UGC Gain was found to be taxable by Respondent based on indicia of a functionally integrated enterprise (evidence of Petitioner's supervisory role via staffing UGC management and director

positions with Petitioner's personnel, direct and regular reporting by UGC personnel to Petitioner's executive and management personnel in charge of UGC, Petitioner's veto of UGC's effort to terminate UGC's marine exploration program) and financial supervision that reflected a "flow of value" (coverage of UGC employees by Petitioner's workers' compensation plans, participation of UGC employees in Petitioner's employee savings plans, Petitioner's providing of insurance, legal, and tax technical assistance for compensation). App. 17a and 18a.

With regard to the ASARCO Gain, however, the New Jersey Supreme Court asserted that the relationship between Bendix and ASARCO was not controlling. App. 18a. In place of a test based on the degree of interaction between the investor and the investee, the court enunciated a series of vague and indefinite phrases which it attempted to call a standard: "the intangible nature of corporate operations;" "the underlying economic realities as evidenced by the facts;" whether an investment goes "beyond the passive corporate investment;" "the existence of exchange or transfer of value." App. 15a, 16a, 20a. From its application of this "standard" to the facts surrounding Bendix's investment in ASARCO, it is apparent that the New Jersey Supreme Court has proposed a definition of Due Process that would allow states to tax a portion of income from intangibles whenever the intangible property is purchased with a conscious intention to make money. If anything, this is a *broader* unitary business standard than the one rejected in *ASARCO*, wherein Idaho asserted that intangible property should be considered part of the unitary business "when the intangibles contribute to or relate to or are some way in furtherance

of the taxpayer's own trade or business." *ASARCO*, 458 U.S. at 326.

ASARCO and *Woolworth* also appear to be factually indistinguishable from this case, except in that the relationships between the investors and the investees in those cases were in many ways *closer* than the relationship between Bendix and *ASARCO*. The New Jersey Supreme Court's attempts to reconcile its decision with these cases were so conclusory and narrow as to appear cynical. The court noted that "ASARCO's stock investments were 'not integral to nor a necessary part of [ASARCO's] business operations'" and that "in neither *ASARCO* nor *F. W. Woolworth* did the taxing State produce any facts that demonstrated the minimal contacts and rational relationships required to satisfy constitutional restraints." App. 21a. In other words, the New Jersey Supreme Court simply said that *ASARCO* and *Woolworth* do not support the conclusion that Bendix and *ASARCO* were not unitary because the taxpayers and the investees in those cases were not unitary. Alternatively, the court distinguished *ASARCO* and *Woolworth* on the grounds that "neither *ASARCO* nor *F. W. Woolworth* involved the purchase of 4,000,000 shares of outstanding corporate stock to enhance the stockholder value in the corporation." App. 21a. By its having suggested that *ASARCO* and *Woolworth* are applicable only to the *precise* sets of facts contained in those two cases, it is clear that the New Jersey Supreme Court believes that *ASARCO* and *Woolworth* have essentially no precedential weight.

C. The Danger in the Allied-Signal Standards

If this decision is not reversed, a number of negative results are likely to occur. The New Jersey Supreme Court's amorphous Due Process standards will no doubt result in a rash of tax assessments seeking the apportionment of income from minority investments in intangibles by states in which the multijurisdictional taxpayer/owner is not domiciled. Apportionment of income allocated to the taxpayer's commercial domicile will result in double taxation of the same income in many situations.⁴ Failure to reverse the elastic Due Process standards urged by the

⁴ Of the 46 states which tax corporate income, 34 allocate (*i.e.*, tax 100% of the income from) gains realized by domiciliary corporations from intangible property in at least some instances: Alabama, Alaska, Arizona, Arkansas, California, Colorado, Delaware, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Minnesota, Mississippi, Missouri, Montana, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, South Dakota, Tennessee, Utah, West Virginia, and Wisconsin. Virginia and the District of Columbia allocate some corporate income, but do not allocate income from intangibles. New Jersey is one of only 11 states that exclusively apportion gains from intangibles; the others are Connecticut, Maine, Maryland, Massachusetts, Michigan, Nebraska, New Hampshire, New York, Rhode Island, and Vermont.

Similarly, 31 states and the District of Columbia allocate dividends from intangibles in at least some instances: Alabama, Alaska, Arizona, Arkansas, California, Colorado, District of Columbia, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Louisiana, Minnesota, Mississippi, Missouri, Montana, New Mexico, North Carolina, North Dakota,

(Continued on following page)

New Jersey Supreme Court in this case also would cultivate fertile ground for a corollary problem: the same states will be able to increase a taxpayer's apportionable income by arguing that a capital loss generated from a similar minority investment is allocable to the taxpayer's commercial domicile.

The potential for abuse created by the Due Process standard used by the New Jersey Supreme Court in this case is clearly evident. Despite the court's repeated assertions that apportionability is determined by the "underlying economic reality" or the "facts or underlying economic activities" concerning the taxpayer and the investee, the court chose to ignore the "facts" and the "reality" of the relationship (or lack thereof) between Bendix and ASARCO. Instead, the New Jersey Supreme Court focused on Bendix's intended use of the proceeds from the ASARCO stock sale – an intention that was ultimately never acted upon. The court below has sought to shift the unitary business test from the ascertainable facts of the investor-investee relationship to a vague, motive-based inquiry that conceivably could be used to

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Ohio, Oklahoma, Oregon, South Carolina, South Dakota, Tennessee, Utah, Virginia, and West Virginia. Connecticut, Delaware, Maine, Maryland, Massachusetts, Nebraska, New Hampshire, New Jersey, New York, Rhode Island, and Vermont exclusively apportion such dividends, while Kentucky, Michigan, Pennsylvania, and Wisconsin exclude dividends from taxable income. *See generally*, All States Tax Guide (BNA) ¶ 223 and specific state entries; State Tax Guide (CCH) ¶ 10-110 and specific state entries.

justify apportionment of virtually any item of income from intangibles.

Companies frequently buy and sell interests in other companies for various reasons. A conglomerate will often buy or sell a subsidiary, a line of business or a segment of its vertically integrated unitary business. These sales occur due to a lack of profitability, to allow expansion into another area of the taxpayer's business, to develop a new line of business, or for numerous other reasons. Occasionally, an attractive minority stock investment opportunity appears. It is often a necessity that the proceeds from these stock sales are used to fund the operational or capital needs of the selling corporation. The New Jersey Supreme Court focused on the vague concept it labelled Petitioner's "investment policy." By lumping **all** of a taxpayer's investment transactions together without examining the underlying unity or diversity of the taxpayer and each investee, a state taxing authority will *always* be able to conclude that the taxpayer has a business function of corporate acquisitions and divestitures that is a long-term integral operational activity of the taxpayer. *See* App. 19a. Income from such an "investment policy" will automatically become apportionable to that state.

The notion that an investment policy reflects an ordinary business practice that somehow "goes beyond the focus" on the existence of a functional or managerial relationship between the taxpayer and an affiliate (*see* App. 19a and 20a) opens a Pandora's box of creative apportionment theories. If a taxpayer's "investment policy" can satisfy both the nexus and rational relationship

Due Process requirements (*see* App. 20a), almost anything will satisfy them.

Other unfavorable results are likely to emanate from the inevitable flurry of state tax litigation if this case is not reversed. Findings that more than one taxpayer is unitary with a single investee will be likely in situations where none of the shareholders has any opportunity to control or significantly influence the investee and no other "traditional" unitary business indicators are present. For example, assume Taxpayer I owns 30% of Corporation I, Taxpayer II owns 30%, Taxpayers III and IV each own 15%, and Taxpayer V owns 10%. Under the rationale of the case at bar, all taxpayers could be deemed to have a unitary relationship with Corporation I. Such a result would make the term "unitary business" an absurdity.

By finding that a taxpayer's investment policy created both nexus and a rational relationship with all non-domiciliary states, all income from the taxpayer's stock investments could be deemed apportionable. A capital gain could then be subjected to double taxation if the taxpayer's commercial domicile deemed the gains to be allocable. Uncertainties created by the ability of state taxing authorities to manipulate or ignore traditional Due Process requirements of apportionability set by this Court will make multijurisdictional state tax planning more like a game of Russian roulette. Future capital investment or expansion in interstate commerce could, therefore, be disrupted by corporations wary of these dismal possibilities.

As this Court is aware, courts in other states do not share the New Jersey Supreme Court's expansive interpretation of the unitary business concept. This Court has recently denied certiorari in two cases in which courts have relied on *ASARCO* and *Woolworth* to overturn efforts to tax capital gains realized by nondomiciliary taxpayers. *Corning Glass Works, Inc. v. Virginia Dep't of Taxation*, 241 Va. 353, 402 S.E.2d 35, cert. denied, ___ U.S. ___, 112 S.Ct. 227 (1991); *Pledger v. Illinois Tool Works, Inc.*, 306 Ark. 134, 812 S.W.2d 101, cert. denied, ___ U.S. ___, 112 S.Ct. 418 (1991). The Virginia and Illinois courts both focused on the taxpayer-investee relationship in determining that the gains at issue in those cases were not unitary business income. Failure to reverse the New Jersey Supreme Court's decision in this case would at the very least send a conflicting message as to the continuing existence of substantial Due Process limitations on state taxation of interstate income.

Regardless of whether this Court chooses to uphold Respondent's taxation of the *ASARCO* Gain, *Amicus TWC* urges the Court to seize the opportunity presented by this case to provide guidance in the area of state taxation of interstate income. If this Court reverses the New Jersey Supreme Court's decision, it is important that this Court's opinion be firm enough to withstand attempts by states to distinguish this case based on insignificant factual differences. If instead this Court fails to reverse the court below, it should enunciate the analytical guidelines that are missing from the New Jersey Supreme Court's opinion.⁵ While *Amicus TWC* strongly believes that the Due

⁵ Should this Court decide in favor of the Respondent, it should also be prepared to confront, either in this case or in the

Process Clause requires a decision in favor of Petitioner in this case, TWC primarily desires that this case result in increased clarity for taxpayers who must deal with the constant threat of double taxation at the state level.

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near future, the issue of what limits (if any) the Due Process Clause imposes on *allocation* of income by a business' state of domicile. As *Amicus* TWC has noted throughout this brief, the Due Process standards urged by Respondent will undoubtedly lead to increasing instances of double taxation; despite earlier pleas by this Court for federal legislative action to create some degree of uniformity at the state level (*see, e.g., ASARCO*, 458 U.S. at 331 (Burger, concurring)), little if any movement in this direction has occurred, nor does any seem likely in the near future.

CONCLUSION

For the foregoing reasons, the decision of the Supreme Court of the State of New Jersey should be reversed.

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